No. 126, Original

In The
Supreme Court of the United States

STATE OF KANSAS,

Plaintiff,

v.

STATE OF NEBRASKA
and STATE OF COLORADO,

Defendants.

COLORADO'S SUR-REPLY IN SUPPORT OF ITS EXCEPTION

JOHN W. SUTHERS
Attorney General of Colorado
DANIEL D. DOMENICO
Solicitor General
SCOTT STEINBRECHER*
Assistant Attorney General

COLORADO DEPARTMENT OF LAW
1300 Broadway
Denver, CO 80203
Telephone: 720-508-6287
Email: scott.steinbrecher@state.co.us
**Counsel of Record*

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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SUMMARY OF ARGUMENT

Colorado takes exception to the Special Master's recommendation that damages in this case include an additional $1.8 million beyond Kansas' loss. Simply put, there is no reliable justification for assessing damages in excess of Kansas' loss. The Special Master found Nebraska's violation was unintentional and not consciously opportunistic. Furthermore, Kansas will be fully compensated by its expectation damages. Nonetheless, Kansas and the United States assert that the measure of damages should include disgorgement of a portion of Nebraska's gains. Kansas Brief at 34-49; Brief of the United States at 19-24. In support of disgorgement, Kansas and the United States cite a number of rationales, each of which is either premised on addressing past Compact violations or an undefined need to deter future Compact violations. Kansas further relies on the mistaken premise that "Nebraska has knowingly violated the Compact for many years." Kansas Reply Br. at 5. These arguments are unfounded for the reasons that follow.

First, Kansas and the United States speculate that Nebraska will comply with the Compact only if the Court removes existing incentives to violate the Compact. They assert that Nebraska has an economic incentive to violate the Compact because water is worth more in Nebraska than Kansas. Yet, no evidence demonstrates that Nebraska chose to violate the Compact due to economic incentives or any other reason. Instead, the record proves that Nebraska's violation was unintentional. Nebraska reduced its

consumption in 2002 and continued to reduce its consumption through 2006, but those reductions proved too little in the face of unprecedented drought. Furthermore, the record proves that even if there might be an economic incentive to violate the Compact, other factors outweigh it since Nebraska has historically complied with the Compact.

Second, an award of disgorgement premised on past violations of the Compact is inappropriate in this case. When the States signed the Final Settlement Stipulation ("FSS"), they waived all claims with respect to conditions occurring before December 15, 2002, including all claims for Compact violations and damages. FSS § I.C. Moreover, the record reveals that Nebraska's past administration has actually benefitted Kansas. For more than a half-century, Nebraska has consistently used less water than its allocation. The unused water has accrued to Kansas' benefit by becoming part of Kansas' allocation under the Compact. Therefore, the record disproves Kansas' assertion that it is vulnerable to abuse by Nebraska and that disgorgement is necessary to compensate for past violations.

Third, the Court should take notice that the calculation of Kansas' loss is already overstated. The Special Master's calculation of damages is based on the existing accounting procedures, which mistakenly charge Nebraska for consuming Imported Water Supply. Report at 70 ("the Court in exercising its equitable discretion should close the books on 2006 under the existing, mistaken procedures."). The amount by

which Nebraska is said to have violated the Compact includes a total of 16,138 acre-feet of Imported Water Supply. C-10 (Tables showing total Change in Compact Balance for Nebraska in 2005 (8,341 acre-feet) and 2006 (7,341 acre-feet)). Nebraska's violation and, therefore, the calculation of Kansas' loss are overstated by as much as 23 percent. *Compare* C-10 *with* Report of the Special Master (hereinafter "Report") at 2 (finding Nebraska consumed a total of 70,869 acre-feet of water in excess of its Compact allocation in 2005 and 2006). This is not to say that Colorado takes exception to the calculation. It does not. Rather, Colorado calls the Court's attention to the already generous calculation of Kansas' loss when evaluating the appropriateness of awarding even greater damages.

ARGUMENT

I. Disgorgement is not necessary to deter future violations.

Kansas and the United States cite a number of rationales in support of disgorgement that are premised on deterring future breaches. For example, they assert that disgorgement is necessary to deter future and ongoing efficient breaches. Kansas Reply Br. at 27 ("[a]bsent an effective remedy that strips Nebraska of the strong economic incentive to violate the Compact, Nebraska's history of violating the Compact is likely to repeat itself"); United States Br. at 20-21 (asserting Nebraska may lack a sufficient incentive to

work diligently to prevent a breach as long as it is willing to suffer the financial penalty); 21 (arguing disgorgement will discourage an efficient breach on an ongoing basis).

These assertions presume that Nebraska officials chose to violate the Compact in favor of an economic gain. The presumption is not supported by evidence in the record. In fact, the record proves the opposite. The Special Master found "no evidence that Nebraska deliberately opted for noncompliance in 2006." Report at 111. In addition, the Special Master found that Nebraska's efforts to comply with the Compact "preclude a finding that this was a consciously opportunistic breach." Report at 131. While the Special Master's calculation of damages suggests that water is worth more in Nebraska than Kansas, there is no evidence in the record that Nebraska officials made such a calculation or considered the relative value of water as part of their efforts to Comply with the Compact in 2005 and 2006. Furthermore, Kansas' own evidence proves that even if an incentive exists for Nebraska to use more than its allocation under the Compact, that incentive is outweighed by others since Nebraska typically uses much less than its allocation. Between 1959 and 2007, Nebraska used 2.4 million acre-feet less water than it was allocated. *See* Kansas Reply Br., app. B. The historical accounting does not support the speculative assertion that Nebraska will violate the Compact in the future unless the Court strips Nebraska of its alleged incentive. The Court should not award disgorgement based on such a speculative assertion.

Moreover, the record does not demonstrate that a future violation will occur or is even likely to occur. The Special Master found Nebraska has the tools necessary to ensure compliance and found that Kansas' own projections of Nebraska's future use posited "no material increase in the annual stream flow depletions by groundwater pumping over the next ten years." Report at 119 (citing K24 at KS741-48 & Figures 4-9). Furthermore, Kansas' own witnesses could not predict any future violation or the percentage likelihood of a violation in the next 60 years. Report at 119-120. This Court should not award disgorgement on the premise of deterring future breaches because the record does not demonstrate that a future violation will occur or is even likely to occur.

II. Disgorgement is unwarranted because Nebraska's violation did not result from an unreasonable failure to reduce its consumption.

The Court should not award disgorgement because Nebraska's violation in 2006 was not a result of an unreasonable failure to reduce its consumption. *Contra* Kansas Reply Br. at 35 (arguing disgorgement appropriate where breach results from unreasonable failure, despite notice and opportunity, to avoid or rectify the unjust enrichment in question.). Nor was the violation a result of Nebraska's negligence. *Id.* (arguing disgorgement is appropriate when a significant cause of the defendant's unjust enrichment is the defendant's negligence).

Contrary to Kansas' argument, the record demonstrates that Nebraska's failure was not unreasonable, nor was it the result of negligence. Nebraska reduced its consumption immediately in 2002 and continued to reduce its consumption through 2006. *See* Kansas Reply Br., app. B. Nebraska reduced its consumption well below its historical average allocation and even below its average allocation for historically dry periods. *See id.* Unfortunately, Mother Nature reduced Nebraska's allocation to the lowest ever seen and Nebraska's efforts proved too little to assure Compact compliance. *See id.*

Under the Compact and the FSS, each State is allocated a percentage of the computed water supply of the Republican River Basin and its tributaries. Republican River Compact, art. III (allocations are "derived from the computed average annual virgin water supply"); FSS, app. C, § III at C15 (allocations for each State calculated as a percentage of the computed water supply). If the computed water supply increases, then the States' allocations also increase. The inverse is also true – if the computed water supply decreases, then the States' allocations decrease. The computed water supply largely comprises measured gage flows and computed beneficial consumptive use by the States. *See* FSS, app. C, § III at C15. Therefore, when flows in the river are higher, the States' allocations are larger. When there is less water in the river, the States' allocations are smaller.

In this case, the record demonstrates the dramatic role of climate in determining the States' allocations.

Prior to 2002, Nebraska's average allocation was 318,071 acre-feet. *See* Kansas Reply Br., app. B. Even during the driest period reported in Appendix B, which was the years 1991 and 1992, Nebraska's average five-year allocation never dropped below 253,390 acre-feet. *See id.* Even relying on Kansas' overstated consumption amounts, in 2005 and 2006 Nebraska's consumption was below 253,000 acre-feet. *Compare id. with* Report at 79 (finding Kansas' estimate of Nebraska's overuse in 2006 should be reduced by 8,091 acre-feet). If the climate had replicated even the driest conditions prior to 2002, Nebraska likely would have been able to comply with the Compact in 2005 and 2006.

The problem however, was that Nebraska faced conditions that were even drier than the driest years on record thus far. The result of this unprecedented drought was the dramatic decrease in Nebraska's allocations below the lowest allocation ever calculated. Kansas Reply Br., app. B (showing that for 2005 and 2006, Nebraska's allocation was only 198,940 acre-feet and 187,360 acre-feet, respectively.) In response, Nebraska reduced its consumption well below its historical average allocation and even below its average allocation for historically dry periods. *Id.* Unfortunately these efforts were not enough and Nebraska violated the Compact.

To be clear, the drought does not absolve Nebraska of its violation. Kansas is entitled to damages for its loss. But given the unprecedented drought and Nebraska's sincere efforts to reduce its allocation

below its average allocation for historically dry periods, Nebraska's violation was not an unreasonable failure to reduce its consumption or the result of negligence. Furthermore, Nebraska's violation does not demonstrate a willful intent to violate the Compact. *See* Special Master's Second Report at 80, *Kansas v. Colorado*, No. 105, Orig. (Sept. 1997) ("[t]he lack of willfulness behind Colorado's violation of the Compact serves to distinguish the cases cited by Kansas in support of [disgorgement]."). Therefore, the Court should limit damages in this case to Kansas' loss.

III. Disgorgement is unnecessary since Kansas will be fully compensated by its expectation damages.

The Court should not award disgorgement because Kansas will be fully compensated by its expectation damages. Kansas argues that it will be "inadequately protected by the legal remedy of damages for breach," and that anything less than water "much less an 'approximation' of Kansas' loss nearly ten years after the fact, is a poor substitute for Kansas' right to water under the Compact." Kansas Reply Br. at 35-36. These arguments cannot succeed for two reasons. First, the record demonstrates that Kansas' damages are not undervalued; if anything, Kansas' damages are overvalued since their calculation includes charging Nebraska for consuming Imported Water Supply. Report at 70 (recommending the Court "close the books on 2006 under the existing, mistaken procedures"). Second, Kansas has already argued in

favor of awarding money damages instead of specific performance. Kansas Brief in Support of Exceptions at 44 ("money damages can be an appropriate remedy in Original cases"); Report at 129 ("all three states agree that the remedy should be in dollars, not water"). The Court should not award disgorgement based on Kansas' claim that the money damages for which it argued and to which it agreed are insufficient.

IV. Disgorgement as remedy for past violations would be inappropriate in this case.

Kansas' arguments in support of disgorgement are based on the unfounded premise that "Nebraska has knowingly violated the Compact for many years." Kansas Reply Br. at 5; *see also id.* at 6 ("Nebraska exceeded its Compact allocations numerous times from 1968 to 1991"); at 37 ("rationales of disgorgement strongly favor invoking that remedy for Nebraska's repeated violation of the Compact"); at 45 ("Nebraska has been exceeding its allocations under the Compact for a very long time"); at 46 ("Nebraska simply chose not to take steps necessary to reduce its consumption, even though time and again Nebraska knew that it was on track to violate the Compact"); and at 48 (arguing disgorgement "is particularly appropriate here because history unfortunately has proven that Kansas' position under the Compact is vulnerable to abuse by Nebraska"). Kansas' statements, however, are disproven by the record, and its claim for damages based on past violations is precluded by the FSS.

When the States signed the FSS, they waived all claims with respect to conditions occurring before December 15, 2002, including all claims for Compact violations and damages. FSS § I.C. Therefore, an award of damages premised on past violations is inappropriate in this case.

Moreover, the record reveals that Nebraska has consistently used less than its allocation under the Compact and that Nebraska's past administration has actually benefitted Kansas. When Nebraska uses less water than it is allocated, that water becomes part of Kansas' allocation under the Compact. Compact, art. IV (allocating to Kansas "the entire water supply originating in the Basin downstream from the lowest crossing of the river at the Nebraska-Kansas state line"). Between 1959 and 2007, Nebraska used a total of 2,429,694 acre-feet less than its allocations under the Compact. *See* Kansas Reply Br., app. B. The water left unused by Nebraska was in turn available to Kansas. The amount of water left unused between 1959 and 2007 (2.4 million acre-feet) is forty times greater than the amount of Nebraska's overuse in 2005 and 2006. *Compare* Kansas Reply Br., app. B *with* Report at 2 (finding Nebraska consumed 70,869 acre-feet in excess of its allocation in 2005 and 2006). Even considering the other years when Nebraska used more than its allocation, the pattern of underuse does not change. Between 1959 and 2007, Nebraska's total underuse exceeded its total overuse by 600%. *See* Kansas Reply Br., app. B. Put simply, the record disproves Kansas' assertion that its position has been

historically subject to abuse. Instead, it proves Kansas historically benefitted under Nebraska's administration under the Compact.

V. Disgorgement is unwarranted because Nebraska has no fiduciary duty to Kansas.

Similar to Kansas, the United States sets forth a number of rationales in support of awarding disgorgement of some of Nebraska's gains. *See* United States Brief at 19-22 (disgorgement appropriate as an additional sanction to reinforce the stability of the contract; and blameworthiness in interference with property). Colorado generally disagrees with the United States for the reasons set forth above and in the *Brief in Support of Colorado's Exception to the Report of the Special Master* and *Colorado's Reply in Opposition to Kansas' Exceptions*. Of particular concern, however, is the United States' assertion that disgorgement is justified because of the fiduciary-like relationship that is established when states enter into an interstate water compact.[1] United States Br. at 23. The terms of the Republican River Compact do not contemplate nor provide for a "relationship analogous to a fiduciary," and implying such relationship

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[1] In its *Brief in Support of Exceptions*, Kansas makes a similar argument, but concedes the Compact neither creates nor implies a fiduciary duty. Kansas Brief in Support of Exceptions at 52 ("To be clear, Kansas is not arguing that the Compact literally creates a fiduciary duty or any implied duty.").

frustrates principles of federalism and interferes with separation of powers.

The law regulating the role of a fiduciary is a complex, judge-made law that is based on a fact-specific inquiry. *See generally*, Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 Duke L.J. 879, 879 (1988). Notably, it has never been applied as a general doctrine to an interstate compact. *See generally, Alabama v. North Carolina*, 560 U.S. 330, 351 (2010). Broadly, "a fiduciary relationship is one of trust and confidence in which one of the parties owes to the other party a duty of utmost loyalty and good faith." Robert S. Adler & Richard A. Mann, *Good Faith: A New Look at an Old Doctrine*, Akron L. Rev., 31, 34 (Summer 1994) (citing DAN B. DOBBS, REMEDIES §10.4 at 680-681 (1973)). A fiduciary has responsibilities beyond that of an arm's length agreement. A fiduciary also owes a duty of full disclosure of all relevant facts that are known or should be known by the fiduciary when entering into a transaction with the beneficiary. *Id.* at 34-35 (citing W. Page Keeton et al., Prosser and Keeton on the Law of Torts § 106 at 739 (5th ed. 1984)). Moreover, a fiduciary must act in the interest of the beneficiary, not in his or her own interest or in the interest of a third party. The fiduciary's loyalty must be undivided, and his or her own actions must be devoted to represent and promote the interest of the beneficiary. *Id.* at 35 (citing DAN B. DOBBS, REMEDIES §10.4 at 681 (1973)).

The United States highlights in its brief that disgorgement is an appropriate remedy against a party who benefits by breaching a fiduciary relationship. Brief of the United States at p. 23. It then asserts, without legal support or analysis, that an upstream state that is signatory to an interstate compact, is "in some respects in a position analogous to that of a fiduciary that is charged by the compact with ensuring an adequate amount of water in its possession flows to a downstream state." *Id.* Notwithstanding the number of qualifications the United States includes in alleging a fiduciary relationship exists among parties to an interstate water compact, no fiduciary-like relationship exists among the parties to the Republican River Compact.

The Compact allocates amongst the States water from the Republican River Basin. Compact, arts. III-IV. To that end, the Compact sets out the terms for all parties to share the benefits and burdens of a variable water supply based on the agreement of the States negotiating at arm's length. The mere fact that the States negotiated a compact to clarify the apportionment of the Republican River in lieu of seeking an equitable apportionment by this Court does not justify the conclusion the Compact further imposes fiduciary duties on Nebraska.

Likewise, the Compact's provisions do not evince the creation of a fiduciary-like relationship. The Compact requires all three states to administer the Compact through the official in each state who is charged with administering the public water supplies.

Compact, art. IX. Moreover, the Compact is devoid of any mention that an upstream state must somehow manage the water within its boundaries to promote the interests of a downstream state. *But see*, Robert S. Adler & Richard A. Mann, *Good Faith: A New Look at an Old Doctrine*, Akron L. Rev., 35 (Summer 1994) (citing DAN B. DOBBS, REMEDIES §10.4 at 680-681 (1973)). In fact, the Compact appears to contemplate the opposite by acknowledging that administration of water rights and operation of water facilities are subject to the laws of the state within which the resource is found. *See* Compact, arts. V, VIII, and XI.

Finally, implying a fiduciary-like relationship in interstate water compacts risks unintended consequences that this Court has been unwilling to ignore. An important impetus for states to enter into compacts is the ability to reinforce state sovereignty and avoid federal intervention in areas that have otherwise been considered the purview of state authority. However, the United States' argument suggests that the states agreed to limit their sovereignty and act on behalf of another state simply by entering into the interstate compact. To the contrary, this Court has found that states "rarely relinquish their sovereign powers" and that any determination that such relinquishment has occurred "must be done by clear indication and not inscrutable silence." *Tarrant Regional Water District v. Herrmann*, 2013 U.S. LEXIS 4542, 31 (2013). The same reasoning applies here – the Court should not imply a fiduciary-like relationship into the Compact, and thereby rewrite an

agreement among sovereign States, simply to justify a damages award beyond what is contemplated by breach of contract.

Even if the Court were inclined to ignore principles of federalism and imply a fiduciary relationship into the Compact, it cannot. As this Court has recognized, "an interstate compact is not just a contract; it is a federal statute enacted by Congress." *Alabama*, 560 U.S. at 351. By its own admission, the Court cannot add provisions to a federal statute, and "a statute which is a valid interstate compact is no different." *Id.* at 352. Accordingly, the Court has already decided that it will not read terms into a compact "no matter what the equities of the circumstances might otherwise invite." *Id.*

The Compact imposes no express fiduciary-like relationship among the parties. Nor do its terms evince such relationship was intended. This Court, should therefore, preserve the principles of federalism and separation of powers that serve as a foundation for interstate compacts and reject the United States' argument that disgorgement of some of Nebraska's gains are warranted because of some fictitious fiduciary-like relationship that it wrongfully asserts must exist in the Compact.

CONCLUSION

The record demonstrates that Nebraska did not intentionally violate the Compact. It also demonstrates that Nebraska reduced its consumption in 2002 and continued to reduce its consumption through 2006. Those reductions were not enough for Nebraska to achieve compliance in the face of unprecedented drought. For Nebraska's failure, Kansas is entitled to recover its loss. The Court should not, however, expand damages beyond Kansas' loss.

Kansas waived its right to seek damages for violations occurring prior to 2002. Therefore, damages premised on past violations are inappropriate in this case. Furthermore, the record does not support Kansas' arguments that Nebraska has abused its position as the upstream state. Rather, the record demonstrates that Nebraska has consistently used less than its allocation, and that water left unused has accrued to the benefit of Kansas.

Nor does the record support the argument that disgorgement is necessary to deter future breaches. There is no finding that Nebraska opportunistically chose to violate the Compact, rather than incur the expense of compliance. There is also no evidence to suggest that Nebraska is likely to violate the Compact again in the future. Therefore, the Court need not award disgorgement as a deterrent against future violations.

Respectfully submitted this 30th day of April, 2014.

JOHN W. SUTHERS
Attorney General of Colorado
DANIEL D. DOMENICO
Solicitor General
SCOTT STEINBRECHER*
Assistant Attorney General

COLORADO DEPARTMENT OF LAW
1300 Broadway
Denver, CO 80203
Telephone: 720-508-6287
Email: scott.steinbrecher@state.co.us
**Counsel of Record*